

This letter answers whether a list of items is subject to sales/use tax in Illinois. (This is a GIL.)

November 21, 2000

Dear Xxxxx:

This letter is in response to your letter that was received in our office on June 26, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be accessed at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

Attached is a list of products and services the firm purchases on a daily basis. In order to maintain compliance with the sales & use tax regulations within your jurisdiction, it would be greatly appreciated if you could indicate whether each item is subject to sales and use tax. Please feel free to enter any relevant details that you feel pertain to each product or service.

In addition, we would appreciate any reference material (e.g.: State Sales & Use Tax manuals, Codes, or Website address) you could provide. A self-addressed mailing label is included for your convenience.

If you need to contact me, I can be reached at #####

Regarding your list of products and services, we are describing their tax consequences in narrative form in order to provide a more detailed explanation. Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. Section 2 of the Illinois Retailers' Occupation Tax Act, 35 ILCS 120/2, imposes a tax upon persons engaged in the business of selling at retail tangible personal property such as artwork, books, equipment, furniture and supplies. Section 3 of the Illinois Use Tax Act, 35 ILCS 105/3, imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer.

For general informational purposes we enclose a copy of 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases. Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation and Use Tax purposes. Lessors are subjected to a Use Tax on their cost price or acquisition value of tangible personal property that they use by leasing in Illinois. This means lessors encounter a front-end tax on value rather than an amortized tax on receipts. The only exception is automobiles rented

for one year or less which are subject to liability under the Automobile Renting Occupation and Use Tax Act, 35 ILCS 155/1-5.

True leases generally have no buy out provisions at the close of the leases. If buy out provisions do exist, they must be fair market value buy out options in order to maintain the character of the true leases. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See, 86 Ill. Adm. Code 130.220(a). As end users of tangible personal property located in Illinois, lessors incur Use Tax liability on their cost price of such property. Because of this, it would not be proper for a lessor to give a resale certificate when it acquires property to be leased under a true lease in Illinois.

Under Section 130.2010(a), persons who purport to "lease" the use of property, but in fact sell such tangible personal property to nominal "lessees," are considered to be making conditional sales whose total receipts are subject to Retailers' Occupation Tax. Such would be the case when the agreements contain one dollar or other nominal purchase options.

Regarding materials used in construction, please be advised persons who take tangible personal property and permanently affix it to real estate act as construction contractors. See the enclosed copy of 86 Ill. Adm. Code 130.1940. Examples of construction contractors are persons who build buildings and persons who sell and install central heating or cooling systems, or parts thereof, such as air conditioner compressors or furnaces. Construction contractors incur Use Tax and local Retailers' Occupation Tax reimbursement liabilities, payable to their suppliers, based upon their cost price of items which they purchase for subsequent incorporation into real estate. If contractors' suppliers are not registered to collect Illinois tax, contractors must self assess the tax and pay it directly to the Department.

Construction contractors incur Retailers' Occupation Tax liabilities when they sell items that remain tangible personal property when installed. Examples are window air conditioning units and gas or electric stoves. Please see Section 130.1940(b).

Materials transferred in transactions involving repairs of tangible personal property are generally subject to liability under the Service Occupation Tax Act. See 86 Ill. Adm. Code 140.101 and 140.140(l). Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident of their sales of service. Servicemen incur either Service Occupation Tax (SOT) liability or Use Tax liability in these transactions. The tax consequences depend upon the method used to calculate the liability. Servicemen may calculate their tax base in one of four ways: 1. separately stated selling price; 2. 50% of serviceman's entire bill; 3. SOT on his cost price if he is a registered de minimis serviceman; or, 4. Use Tax on his cost price if he is a de minimis serviceman not required to be registered under Section 2a of the Retailers' Occupation Tax.

Enclosed is a copy of 86 Ill. Adm. Code 130.2105 concerning Sellers of Newspapers, Magazines, Books, Sheet Music and Phonograph Records, and their suppliers. Please note sales of magazines are not subject to sales tax, Section 130.2105(a)(2). In making determinations on whether publications such as newsletters qualify as magazines for purposes of exemption from tax, there is one test that must be met and several other factors to be considered. The test that must be met in order for publications to qualify as magazines is that they must be published periodically, that is, they must be published at least two times per year. They must also possess at least one characteristic of a magazine. Such characteristics include whether the publications can be subscribed to, whether they contain articles on subjects of general interest, whether they contain general advertising, and whether they have the format of magazines such as soft covers, individual pages, and indexed articles.

Relative to the items you list in Computer Products, please note Illinois law imposes Retailers' Occupation Tax upon persons who sell canned computer software at retail. Computer software means a set of statements, data, or instructions to be used directly or indirectly in a computer in order to bring about a certain result in any form in which those statements, data, or instructions may be embodied, transmitted, or fixed, by any method now known or hereafter developed, regardless of whether the statements, data, or instructions are capable of being perceived by or communicated to humans, and includes prewritten or canned software that is held for repeated sale or lease, and all associated documentation and materials, if any, whether contained on magnetic tapes, discs, cards, or other devices or media (35 ILCS 120/2-25). The sale of canned software to Illinois users is considered to be the taxable sale of tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. See 86 Ill. Adm. Code 130.1935(a), enclosed. Tax applies to the entire charge made to the customer, including charges for all associated documentation and materials. Charges for updates of canned software are considered to be sales of software. Charges for training, telephone assistance, installation and consultation are exempt if they are separately stated from the selling price of canned software. Please refer to 86 Ill. Adm. Code 130.1935(b).

In general, gross receipts vendors receive from computer software licenses are subject to Retailers' Occupation Tax, unless the license agreements contain certain conditions. Licenses of software may not be subject to tax if the licenses meet all the criteria set out in 86 Ill. Adm. Code 130.1935(a)(1)(A-E). Please see the guidelines contained in the enclosed copy of 130.1935.

In order to be non-taxable, licenses must include the following provisions: 1. written agreements signed by licensors and customers; 2. restrictions limiting customers' duplication and use of the software; 3. restrictions prohibiting customers from licensing, sublicensing or transferring the software to unrelated third parties; 4. policies or provisions that vendors will provide another copy at minimal or no charge if customers lose or damage the software; and 5. requirements that customers destroy or return all copies of the software to vendors at the end of license periods.

Regarding provision 4 that requires the license to contain a condition requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software, the Department has deemed this condition to be met if the vendor's records reflect that it has a policy of providing copies of software at minimal or no cost if the customer loses or damages the licensed software.

Provision 5 requires a license to contain a condition requiring the customer to destroy or return all copies of the software to the vendor at the end of the license period. Please be informed the Department has deemed perpetual license agreements to qualify for this condition even though no provision is included in the agreement that requires the return or destruction of the software.

Maintenance agreements for computer software are generally treated the same as maintenance agreements for other types of tangible personal property, such as computer hardware. Please refer to subsection (b) of the enclosed copy of 86 Ill. Adm. Code Sec. 130.1935. The taxability of maintenance agreements depends upon if charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance agreements are sold separately from tangible personal property, sales of the agreements are not taxable transactions. However, when maintenance services or parts are provided under the maintenance agreements, the service or repair companies will be acting as service providers under provisions of the Service Occupation Tax Act that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See part (3) of subsection (b) of the enclosed copy of 86 Ill. Adm. Code Sec. 140.301.

As noted above, charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreements would be taxable as sales of canned software.

In general, the provision of services in Illinois without the transfer of tangible personal property is not subject to sales/use tax. The sale of service accompanied by the transfer of tangible personal property, such as printing, is subject to liability under the Service Occupation Tax Act, as noted above.

In Illinois, the Hotel Operators' Occupation Tax Act imposes a tax upon persons engaged in the business of renting, leasing or letting rooms in a hotel. See 86 Ill. Adm. Code 480.101, enclosed. The Hotel Operators' Occupation Tax Act does not include any provision for the exemption of exclusively religious, charitable, or educational organizations, or for governments or their agencies. See Section 480.101(b)(3) and (4).

The only exemptions available to hotel operators are for rentals to permanent residents and to certain diplomatic personnel. The exemption for rentals to certain diplomatic personnel applies only to diplomatic personnel possessing certain types of diplomatic tax exemption cards, issued by the U.S. Department of State, Office of Foreign Missions. Please refer to 86 Ill. Adm. Code 130.ILLUSTRATION A and 480.105, enclosed.

The Telecommunications Excise Tax Act imposes a tax on the act or privilege of originating or receiving intrastate or interstate telecommunications by persons in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers by such persons, 35 ILCS 630/3 and 4. The Act defines gross charges as including amounts paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by retailers, 35 ILCS 630/2(a).

While taxpayers providing internet access services may be engaged in activities subject to the Telecommunications Excise Tax, as a general proposition, persons that provide subscribers access to the Internet and who do not, as part of that service, charge customers for the line or other transmission charges which are used to obtain access to the Internet, are not considered to be telecommunications retailers. It is our general understanding that most Internet access providers do not, as part of their billing, charge customers for such line charges, but instead, pay all transmission costs to their telecommunications providers. The single monthly fee charged by such retailers, which often represents a flat charge for a package of items as diverse as E-mail services, and access to daily news summaries is generally not subject to the Telecommunications Excise Tax under these circumstances.

If retailers charge for the transmission of data, as well as for the data itself, Section 495.100(c) of the Telecommunications Excise Tax regulations provides that charges for the data processing or inquiry would not be subject to tax, but charges for transmission of the data would be taxable, so long as the charges for each is disaggregated and separately identified in the books and records of the retailer. If these charges for transmission and data services are not thus disaggregated, the entire charge is taxable as a sale of telecommunications.

In Illinois the Gas Revenue Tax is imposed upon persons engaged in the business of distributing, supplying, furnishing, or selling natural gas to persons for use or consumption and not for resale. See 86 Ill. Adm. Code 470.110.

The Electricity Excise Tax is imposed upon the privilege of using in this State electricity purchased for use or consumption and not for resale. See 35 ILCS 640/1 et. seq. The incidence of this tax is upon the consumers of electricity. Except for customers who elect to become self-assessing purchasers, the tax is collected from customers by their delivering suppliers who maintain a place of business in this State. See 35 ILCS 640/2-7.

As a technical proposition, handling charges represent a retailer's cost of doing business, and are consequently always part of gross charges subject to tax. See, 86 Ill. Adm. Code 130.410, enclosed. However, such charges are often stated in combination with shipping charges. In this case, charges designated as "shipping and handling," as well as delivery or transportation charges in general, are not taxable if it can be shown that they are both separately contracted for and that such charges are actually reflective of the costs of shipping. To the extent that shipping and handling charges exceed the costs of shipping, the charges are subject to tax. As indicated above, charges termed "delivery" or "transportation" charges follow the same principle.

Whether transportation or shipping charges may be deducted by retailers in calculating Retailers' Occupation Tax liability depends not upon the separate billing of such transportation or handling charges but upon whether the charges are included in the selling prices of the property or are contracted for separately by purchasers and retailers. The best evidence that delivery charges were agreed to separately and apart from selling prices, are separate and distinct contracts for freight or shipping. Alternatively, documentation in the records of sellers that purchasers had options of taking delivery of the property at sellers' locations, for the agreed purchase prices, or having delivery made by sellers for the agreed purchase prices plus ascertainable delivery charges, may suffice.

Mail order delivery charges are deemed to be agreed upon separately from the selling price of the tangible personal property being sold so long as the mail order form requires a separate charge for delivery and so long as the charges designated as transportation or delivery or shipping and handling are actually reflective of the costs of such shipping, transportation or delivery. To the extent that such charges exceed the costs of shipping, transportation or delivery, the excess charges are subject to tax. See section 130.415(d).

You have not provided sufficient information about some of the items on your list for us to determine their tax status in Illinois. If you wish to obtain a complete copy of the Department's administrative rules on the Illinois Retailers' Occupation Tax, Use Tax, Service Occupation Tax, and Service Use Tax, we request a minimal fee to defray photocopying costs. You may obtain this sales tax rulebook by sending \$6.50 to this office, attention Margaret Forth.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Karl W. Betz  
Associate Counsel

KWB:msk  
Enc.